



# CITY OF LONG BEACH

DEPARTMENT OF FINANCIAL MANAGEMENT

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July 13, 2010

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

## RECOMMENDATION:

Receive and file the Comprehensive Annual Financial Report (CAFR), Separately Issued Financial Statements and the Federal Single Audit for the Fiscal Year Ended September 30, 2009. (Citywide)

## DISCUSSION

### **Comprehensive Annual Financial Report**

The Comprehensive Annual Financial Report (CAFR), prepared by the Financial Management Department, contains audited financial information on all City funds for the fiscal year ended September 30, 2009 (FY 09) in accordance with generally accepted accounting principles. In accordance with Section 302(e) of the City Charter, the CAFR is submitted annually to the City Council. It is important to note that the CAFR is designed to report historical financial information only and is not designed to report financial projections or budgetary priorities.

We are pleased to report that the Independent Auditor's Report, found on page 1, concluded that the City's financial statements present fairly, in all material respects, the financial position of the City, and its related cash flow and budgetary information. The audit was conducted by KPMG LLP, a certified public accounting firm, under contract with the City Auditor.

The CAFR provides Basic Financial Statements that combine all of the City's assets and liabilities in one consolidated statement. Total City net assets, on an all funds basis, as shown on page 27, were \$4.0 billion as of September 30, 2009, which included \$3.3 billion for enterprise operations such as the Harbor Fund, Water Fund and Tidelands Fund. Net assets increased by \$97.4 million from FY 08 and are in the form of buildings, real property, bond proceeds, funds reserved for capital projects, debt service and grants-funded programs. Most of these funds are restricted by federal or state law and are not available for discretionary use.

As of September 30, 2009, the unreserved fund balance for the General Fund reflects the Emergency Reserve of \$39.6 million, comprised of \$37.1 million designated by the City Council, plus \$2.5 million required by the City Charter, which reflects 10 percent of total General Fund expenditures, consistent with the City Council's financial policy.

A separately issued Management Letter accompanying the CAFR provides certain recommendations from KPMG LLP on how the City can improve its financial reporting and internal controls. City management has reviewed KPMG's recommendations and has responded to each issue in the attached letter (Attachment A).

Finally, as a result of the professionalism and dedication of the Department of Financial Management, as well as finance professionals throughout the City who contribute a wide range of detailed and complex data and supporting documentation, the City has again been awarded the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting for the City's Fiscal Year 2008 CAFR. The receipt of the Certificate of Achievement attests to the City's desire to be fully accountable to its citizens. In addition, this recognition can be viewed as a positive factor by credit rating agencies and investment banks that underwrite the City's bonds.

### **Separately Issued Financial Reports and Statements**

In addition to the CAFR, certain City funds, joint powers authorities, and other subsidiary entities are also required to submit audited annual financial statements under separate cover, including the Harbor Department, Water Department, Redevelopment Agency, Long Beach Housing Development Company, and the Aquarium of the Pacific. These separate reports are enclosed and are issued annually to meet distinct legal and financial requirements. The financial statement for Long Beach Transit, a discretely presented component unit of the City, for which the City is the sole shareholder, is also included.

### **Federal Single Audit**

Lastly, the Federal Single Audit required by the Federal Office of Management and Budget for municipalities receiving over \$500,000 annually in federal funds is also enclosed. We are pleased to report that due to the diligence of finance professionals throughout the City, Long Beach's designation as a "high risk" grantee has been removed.

### **TIMING CONSIDERATIONS**

Action on this item is not time critical.

### **FISCAL IMPACT**

There is no fiscal impact associated with this action.

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SUGGESTED ACTION:

Approve recommendation.

Respectfully Submitted,



STEPHEN W. HANNAH  
CITY CONTROLLER



LORI ANN FARRELL  
DIRECTOR OF FINANCIAL MANAGEMENT/CFO

APPROVED:



PATRICK H. WEST  
CITY MANAGER

PHW:LAF:SWH  
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ATTACHMENTS:

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) MANAGEMENT LETTER (ATTACHMENT A)  
COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR THE CITY OF LONG BEACH, CALIFORNIA  
FEDERAL SINGLE AUDIT REPORT  
THE HARBOR DEPARTMENT COMPREHENSIVE FINANCIAL REPORT  
COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE LONG BEACH WATER DEPARTMENT  
REDEVELOPMENT AGENCY OF THE CITY OF LONG BEACH ANNUAL FINANCIAL REPORT  
THE LONG BEACH HOUSING DEVELOPMENT COMPANY ANNUAL FINANCIAL REPORT  
AQUARIUM OF THE PACIFIC FINANCIAL STATEMENTS  
AQUARIUM OF THE PACIFIC CONSOLIDATING FINANCIAL STATEMENTS  
LONG BEACH TRANSIT COMPREHENSIVE ANNUAL FINANCIAL REPORT



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KPMG Tower  
Suite 2000  
355 S. Grand Avenue  
Los Angeles, CA 90071-1568

June 30, 2010

The City Council  
City of Long Beach  
333 West Ocean Blvd.  
Long Beach, CA 90081

Ladies and Gentlemen:

We have audited the financial statements of the City of Long Beach, California (the City), for the year ended September 30, 2009, and have issued our report thereon dated June 30, 2010. In planning and performing our audit of the financial statements of the City, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized below:

#### **Net Assets**

##### ***Observation***

During our audit, we noted that there are no written policies or procedures in place related to the annual review of the classification of net assets as part of the City's comprehensive annual financial reporting process.

##### ***Recommendation***

We recommend that the City formalize its policies or procedures for the documentation and support for the classification of net assets to ensure that the basis of the restriction is external and not an internal designation by the City.

##### ***Management's Response***

The City accepts KPMG's recommendation. However, it is important to note that while formal written policies and procedures are not currently in place, there is an extensive annual review of net assets that is performed during the development of the comprehensive annual financial report. The City will endeavor to formalize policies and procedures for the annual review, classification and documentation of net assets to ensure the basis for the restriction is external and not an internal designation by the City. These new policies and procedures will be developed concurrently with the City's analysis of new fund balance reporting revisions required by the Governmental Accounting Standards Board.



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## **Non-GAAP Policies**

### ***Observation***

During our audit, we reviewed the City's internal control process in place to identify new non-GAAP policies and quantify the impact of new and existing non-GAAP policies to the financial statements. We noted that the City does not have a formal process in place to identify new non-GAAP policies. Furthermore, the City does not perform an analysis during the year to quantify the impact of the new and existing non-GAAP policies to the year-end financial statements. As a result of the procedures performed, we noted the City did not quantify the impact of the following non-GAAP policies:

- Lack of accrual of expenses under \$10,000.
- Recognition of revenue for several revenue sharing agreements in the year subsequent to when the exchange transaction has taken place.
- Recording assets as depreciable when the assets are placed in service.

### ***Recommendation***

We recommend that the City enhance its internal controls related to the documentation and calculation of the impact of non-GAAP policies to ensure that adopted policies do not result in a material misstatement of the financial statements.

### ***Management's Response***

The City accepts KPMG's recommendation. As in the prior fiscal year, the City will identify and correct as many non-GAAP policies as it can during the limited three-month period between the end of the annual audit and fiscal year-end closing. The City is in the process of implementing a procedure that will allow for the identification and accrual of expenses under \$10,000. The City recognizes the necessity and, in conformance with the recommendations of KPMG, will adopt policies and procedures needed to ensure the recognition of revenue for revenue sharing agreements in the year when the exchange transaction has taken place. Finally, the City will continue its efforts to ensure that depreciable assets are recorded when they are placed into service.

## **Pension Data**

### ***Observation***

It was noted in two cases that the information used by CalPERS in the pension liability did not agree with that contained in employee personnel files.

### ***Recommendation***

We recommend that the City establish controls to ensure that the data provided to CalPERS agrees with the information in the employee personnel files. If the information in the employee file is incorrect, these files should be updated on a timely basis to reflect the appropriate changes.



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***Management's Response***

The noted cases, both involving incorrect employee birthdates, were submitted to CalPERS several years ago. The CalPERS system currently does not have a process available, electronic or other, that would allow for an efficient evaluation of this information so that submitted data can be checked for accuracy. The only available option is to check each current and former employee individually against existing City records. CalPERS is in the process of implementing a new system within the next year that should allow for these checks to be conducted en masse. Regardless, and as stated by the City's independent actuary, the errors noted would not result in a material misstatement of the City's pension liability. Once CalPERS brings its new system online, the City will be in compliance with this recommendation.

**Tax Revenue and Receivables**

***Observation***

During our audit, we noted several instances in which management did not evaluate the available criteria for various tax receivables to determine that the funds were received within 60 days of year-end. Therefore, management overstated receivables and revenue.

***Recommendation***

We recommend that the City establish controls to ensure that revenue is evaluated for availability when issuing financial statements.

***Management's Response***

The City accepts KPMG's recommendation. The City has established a new procedure for the review of GASB 33 accrual estimates.

**Account Analysis**

***Observation***

During our audit, we noted several amounts reported in land held for resale in the prior year were reclassified to capital assets or written off. Management reviewed the accounts and determined that the items were improperly reported as land held for resale. The amounts were not previously identified as management did not perform a thorough account analysis. As a result of these errors, capital assets and expenses were not properly reported.

***Recommendation***

We recommend that management review all accounts to ensure that the information presented is accurate. Management's review should include a review for clerical errors as well as an analysis to ensure that the information presented is reasonable given the circumstances. The analyses should be retained and reviewed by a responsible official as part of the monthly closing cycle. This procedure will provide improved assurance that accounting errors will be detected and corrected in a timely manner.

***Management's Response***

The City will endeavor to review the transactions or balances of significant accounts to ensure their accuracy and to allow for correction of errors within a timely manner.



### **IT General Controls – Logical Access 1**

#### ***Observation***

During the performance of testwork over RACF security for the Mainframe environment, we noted that two employees have access to Administrative access, Access to Migrate Changes, and Development access.

#### ***Recommendation***

Consider implementing a periodic monitoring of changes migrated into production to validate the appropriateness of application level changes.

Also, consider performing a periodic review over users with access to security administration functionality on an annual basis to determine that the users cannot escalate their own access, especially if they have the ability to develop/migrate changes into production.

#### ***Management's Response***

These two individuals maintain the software that is used for migrating changes and therefore require total admin rights to these systems to be able to work on them. Will implement yearly review of changes and users for this SCLM system.

### **IT General Controls – Logical Access 2**

#### ***Observation***

During the performance of testwork over RACF security for the Mainframe environment, we noted that one user ID, RACF CHANGE, is utilized as a generic ID for audit trail investigation as part of a security monitoring utility. We further noted that this USER ID has "Special" level access to perform user administration and that users have the capability to log into the stated User ID.

#### ***Recommendation***

Consider performing a periodic review over users with access to security administration functionality on an annual basis. Consider verifying that generic accounts are truly required to perform security administration.

#### ***Management's Response***

The user ID CHANGE was removed from RACF.

### **IT General Controls – Logical Access 3**

#### ***Observation***

During the performance of testwork over Windows Network Security, we noted that one user has multiple Domain Administrator accounts.

#### ***Recommendation***

Consider performing a periodic review over users assigned to the domain administrator role on an annual basis to determine the appropriateness of access.



***Management's Response***

The user no longer has multiple Domain Administrator accounts. We will do yearly review of administrator accounts to determine if they are still appropriate.

**IT General Controls – Logical Access 4**

***Observation***

During the performance of testwork over access to migrate changes, we noted that one user has inappropriate access to migrate changes into the production environment.

***Recommendation***

Consider performing a periodic review over users with access to migrate changes on an annual basis to determine the appropriateness of user accounts.

***Management's Response***

Access was removed. Will implement yearly review of users with migration access.

**IT General Controls – User Administration**

***Observation***

During the performance of testwork over User Administration, we noted that the City currently does not have a formal policy/procedure that establishes a timeframe, which a user must be removed from system access; however, there is an informal timeframe to remove access within 14 days from termination.

During the performance of testwork over User Administration, we also noted that one selected termination had not been removed in a timely manner. We further noted that there has not been a formally defined timeframe, which terminated users' access should be removed/disabled from the system.

***Recommendation***

Consider implementing and enforcing a formally defined timeframe in which terminated employees must be removed from systems.

***Management's Response***

TSD will implement and enforce a formally defined timeframe in which employees who have separated with the City must be removed from system access.

\* \* \* \* \*

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies and communicated them in writing to management and those charged with governance in a separate report dated June 30, 2010.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim,





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however, to use our knowledge of the City's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This communication is intended solely for the information and use of management, City Council and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

The City's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Very truly yours,

**KPMG LLP**